RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

Dec. 17, 1986 **LETTER 954**

Dec. 5 DJIA 1924.78; PTI 2472; A-D Ratio -6.58
Dec. 12 DJIA 1912.26; PTI 2452; A-D Ratio -7.45

THE PICTURE: The Democrats, the cartoonists, and liberals are having the times of their lives. Screams New York's left-wing "Village Voice," "The Reagan Era is Over, the Fat Lady Starts to Sing." The old adage states that time heals all wounds. It remains to be seen whether the adage works this time.

On December 2 the D-J Industrial Average and the D-J Transportation Average broke out together to new bull market highs. Under Dow Theory, this rather rare simultaneous breakout constituted a re-confirmation of the primary bull trend. Nevertheless, skeptics abound, and predictions of the great bull market's demise are heard from the mouths of many of Wall Street's "experts." But as far as Dow's Theory is concerned, the more pessimism the better. Bull markets thrive on disbelief, and this bull market has all the disbelief anyone could reasonably wish for.

Perhaps even more skeptical than the stock market experts are the big-name economists. The fact is that the current economic expansion is now in its 50th month and nobody (least of all the experts) can figure out why the expansion has lasted this long. Furthermore, the "normal" economic signs of old age are still strangely missing.

For instance, at this "late" stage of the business cycle, factory usage normally runs toward the high side. Not so today -- factory usage is still below 80%. Labor costs, which also tend to surge near the end of a long expansion, have been trending down in recent months. The prime rate, which normally would be soaring by now, has also been trending down. And the M-2 monetary gauge (cash plus checking and savings accounts), which normally declines toward the end of a long economic expansion, is still expanding.

What does it all mean? To me, it means that the economy, like the stock market, "can do anything." There simply is no set formula when it comes to economics except this one -- when everyone expects the economy to perform in a certain way, forget it; it's almost guaranteed that everyone is going to be wrong.

The bull has been in the page 2 box for a long time. But I'm still not sure how many subscribers fully understand the meaning of the phrase, "primary bull market." I do know that the press and most analysts don't understand what a primary bull market is, and a good example appeared in the headlines of USA Today on November 26. The caption ran, "Does the Boesky Affair Signal the End of the Bull Market?" You see, the newspaper is thinking of how current events affect the bull market. Obviously, the USA Today editor believes that if the news of the day is good the bull market should go up, and if the news of the day is bad the bull market is probably over.

Another flagrant and ridiculous example of this same kind of misguided thinking appeared on the front page of the New York Times (Dec. 3). Here the Times reporter attempted to explain the Dow's December 2 rise to new bull market highs by referring to President Reagan's decision to appoint an outside counsel to investigate the Iranian affair. That explains it, says the Times; that's why the Dow and the S&P 500 rallied to new record highs. Of course, nothing could be further from the truth.

A bull market doesn't continue in force on the basis of a presidential announcement or the latest leading indicator report or an optimistic prediction by some "name" economist. No, a bull market is the reflection of a tide in the affairs of men. A bull market is a massive unseen force which, in its lifespan, will carry the stock market from the depths of economic depression to the heights of prosperous euphoria.

STOCK PRICES SOAR TO PEAK IN RELIEF OVER IRAN INQUIRY

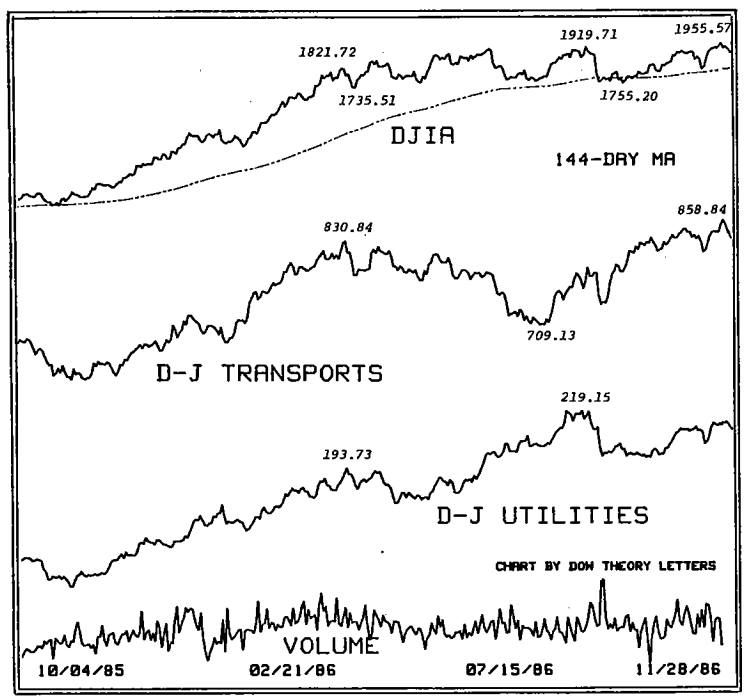
Dow Rises 43.03, to a Record Close of 1,955.57, After Action by President

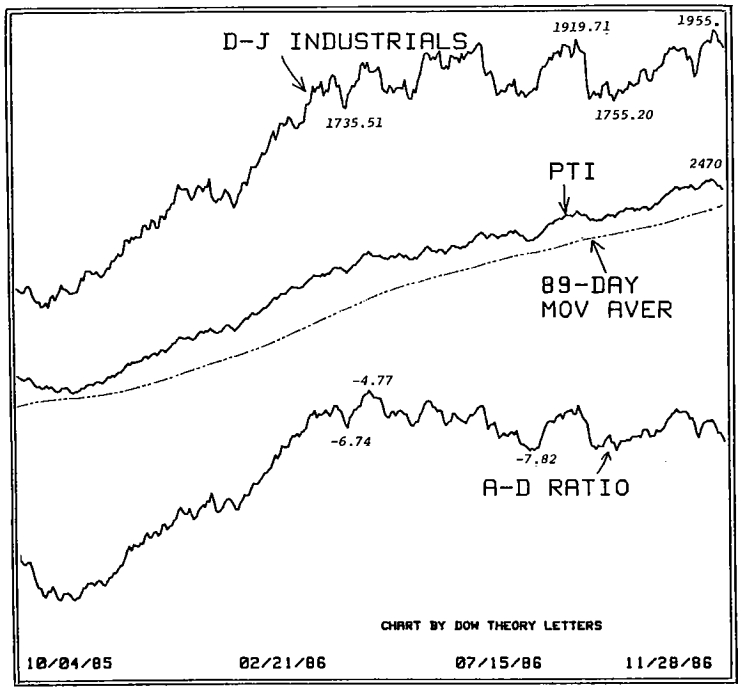
By PHILLIP H. WIGGINS

Stock prices soared to record levels yesterday as the market, relieved that President Reagan had acted to support a full investigation of the Iranian arms sale controversy, staged the third-best rally in its history.

The basic concept that one must understand is that a primary trend, once in force, will FULLY EXPRESS ITSELF before it has ended. For instance, a primary bear market will send stocks lower until the worst that can be seen ahead is fully discounted in the price structure. Let's take some examples: In 1932 the depths of a terrible depression were discounted by an unbelievable Dow low of 41.22. In 1942, the gripping fears of a war-torn America were expressed by a Dow low of 92.92. In 1949 the specter of "a frightening post-war depression" was expressed by a Dow low of 161.60. In 1974 the worst recession since the '30s was reflected in a Dow low of 577.50.

Now let's look at the happier side of the coin. A primary bull market will continue in force until the best that can be seen ahead is fully discounted in the price structure. Examples: the full frenzy of the 1920s "Jazz Age" and "New Era" was expressed by a 1929 Dow high of 381.17. Following the 1929-32 bear market, the





hopes for better times were reflected in the 1937 Dow high of 194.40. Right after World War II, the post-War optimism was expressed by a 1946 Dow high of 212.50. Next, the peak of America's post-War strength and prosperity was reflected in a 1966 Dow bull market high of 995.15.

To take it to the present, a new primary bull market began in late-1974 at Dow 577.60, and that bull market is still in force. As of this writing, the Dow has climbed to a new record high, having doubled in value from its old 995.15 peak of 1966.

What I'm trying to get across to subscribers is that in each bull market stocks have ultimately discounted the BEST that could be seen ahead. The corrections, the daily news tid-bits, the political scandals, the presidential emergencies, the Congressional goofs, the economic shocks, all of these were absorbed in the grip of the primary bull trend.

And that's why I say that the news of today, the Boesky affair, the Iranian investigation, the so-called "triple witching hours," none of these will have any but a TEMPORARY effect on the primary bull market. In fact, news-shocks work to shake out the weak holders (i.e., those holders who panic and dump on the basis of the daily newspaper headlines). The result of each shakeout, of course, is that the bull market becomes that much stronger.

And in my opinion, that's exactly the process that has kept the market so strong. This bull market has been subject to scare after scare, doubt after doubt, crisis after crisis. The result is that the public has been very reluctant to come into the market.

I'd like you to try this on for size: Here we have a bull market that has climbed from Dow 577 in late-1974 to a December 2 high of 1955.57 (a rise of a whopping 1378 Dow points). All right, how many of your own friends own stocks today? What percentage of the people you know actually own stocks? From my own experience, I can say that of all the people I know (and I know a lot of well-fixed people), VERY FEW actually own any stocks. They all seem to own real estate, many own bonds, but very few (incredibly few) own a significant amount of equities.

So here's the crux of this whole piece -- BEFORE THIS BULL MARKET IS OVER, ALL THESE PEOPLE WILL OWN STOCKS, LOTS OF STOCKS. Why do I make that statement? Because I know how bull markets work, and I am a fairly competent student of human nature. Bull markets ultimately get frothy, and people ultimately get greedy. As the market works higher and higher, few will resist the lure and excitement of "easy money" and "fast profits."

Now I'd be a liar if I told you that I know just when the public is going to begin succumbing to the siren call of the Wall Street bull. It could happen in the first quarter of next year or it could occur in 1988 or '89. I don't know and neither does anyone else. But the froth and frenzy WILL COME. And it's exactly that phenomenon which inevitably pushes every major bull market "further and higher than anyone believes possible."

A final comment on the froth and frenzy phase of the bull market. Stocks in the third or final phase of a bull market will frequently rise more in a few days than they did in a few years back in the earlier phase of the bull market.

I learned that lesson the hard way. Here's how I learned it. In the early '60s a veteran Dow Theorist named Justin Barber visited me. We talked all morning, and Barber told me that he had just spent a great deal of time studying an old-line stock which was out of favor, Burroughs Corp. From a price of 26, BGH had collapsed down into the 12 area. Barber told me that BGH was a true turn-around situation, that he knew the company intimately, and that he had put most of his own money into Burroughs.

Barber's thoroughness and intelligence impressed me. I bought 500 shares of BGH. I charted that stock daily, I charted it weekly, I put it on point & figure, I read about it, I watched it like a hawk. The blasted stock would run up to 16, then back off to 12, then stagger up to 16 again. It did this for what seemed like ages (actually, the process took about 18 months). Then one day BGH broke out. The stock pushed up to 20 then 30, then (I couldn't believe it) 40. I had tripled my investment in less than two years. Convinced that I was a genius, I sold out my BGH. I took the money and ran. After all, who can fault that kind of profit?

The bull market was still very much in force. BGH continued to climb. To my chagrin (and, horror, I might add) BGH climbed to over 100 and then up to 170 in 1970 (boy, had Justin Barber been right). A sharp correction followed, and then the move resumed in earnest. BGH finally topped out in 1973 at a price of (would you believe) 244! And Richard Russell had learned a valuable lesson. Stay with the primary bull trend. Don't try to out-guess the bull. The stock market "can do anything" and so can any given stock.

So here's the secret that I learned the hard way: In a bull market buy a DIVERSIFIED list of good, dividend-paying stocks and ride 'em until the bull market is well into its third and final (frothy) phase. Then you sell out, and you stay out until the bear market arrives, and you continue to stay out until that bear market runs its course.

"Will there be a third, frothy phase to this bull market?" you ask. "And will there be a bear market following this bull market?" Count on it, dear readers, COUNT ON IT.

TECHNICAL COMMENT: The daily advance-decline line peaked out on April 21, 1986. Despite new all-time highs in the Dow and most of the major averages, the daily A-D line has not been able to better its April 21 high. Many technicians term this a major danger signal, an indication of divergence, and on that basis they believe the bull market is on borrowed time.

Two outcomes are possible from this Dow/breadth divergence. (1) The Dow will turn down in the face of the continuing divergence, and the situation will give way to either a full correction or a bear market. (2) The diverging breadth, unable to bring the Averages down, will bottom out, then head up (along with the Averages) and finally break out above the April 21 high. The divergence will thus be eliminated, and the bull market will continue in full force.

This is how I see it: The price/breadth divergence has been in place for eight months. During this time the D-J Industrial and Transport Averages have (as late as Dec. 2) re-confirmed the primary bull market. During the eight months since the A-D ratio high last April 21, the A-D has given up a mere 3 points. Those 3 points represent a very MINOR loss for the A-D ratio over a period of eight months. In fact, it seems to me that this market is absorbing carloads of bad news, while at the same time it is basically holding together.

I also feel that the market over the last eight months has been trying to build a bottom. It's as if it is groping its way toward some important over-sold condition or some major cyclical bottom (many astute cycle students, including Eliades and Prechter, are pointing to a major cyclical bottom to appear in January or February).

At any rate, we have heard endless types and varieties of bearish predictions during the course of 1986. During that period the Averages have had every chance to deliver a classic Dow Theory bear signal. Yet no such signal has appeared, and we aren't even close to one now.

From all that I see, the evidence suggests that we are in a bull market that has further (maybe a lot further) to go on the upside. The remarkable and continuing strength of the D-J Averages during 1986 has frustrated those who say that the bull market is on its last legs or that it is over.

INVESTMENT POSITION: As far as stocks are concerned, the bull's in the box. Secondary stocks remain mixed to weak, while the strength of the market continues to reside in the blue chips (which is where my subscribers have been all along). Blue chips I like now are Bordens, Bristol Myers, Amer. Home Products, JP Morgan, HJ Heinz. Meanwhile, the stock market is consolidating, backing off, absorbing its gains as well as absorbing the bundles of rotten news coming out of Washington. Patience is the key word here. Oft–recommended Tri-Continental (the big closed-end fund) just declared a whopping capital gains extra of $4.34 in addition to its 28¢ regular dividend.

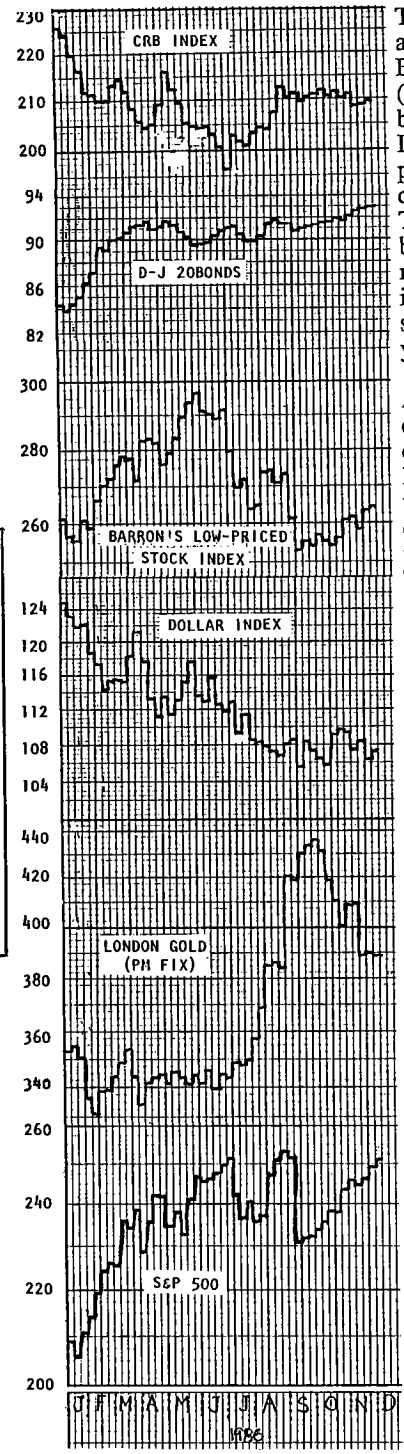
THE PLACE TO BE: This is a NEW feature for Dow Theory Letters. It's a study I've been thinking about for a long time but never got around to actually producing (now, thanks to my wife, Faye, who gathered the statistics and drew the charts, it's done). The study is very basic, and I'm really surprised that nobody else has done it. What we see here is a ratio chart containing the major investment categories. I will update this study in future Letters as important changes occur.

So let's examine the trends in the main areas of investment. We have plotted seven major investment categories on semi-logarithmic chart paper. For the benefit of new readers, semi-log or ratio charts are constructed so that all moves are shown in PERCENTAGES. For instance, a rise from 3 to 6 (which is a 100% rise) on ratio chart paper will take exactly as much vertical space as a rise from 35 to 70 (which is also 100%) or a rise from 900 to 1800 and so on. In this way, any item can be correctly COMPARED with any other item. The angle of ascent or descent will immediately show us the various RATES of growth or decline. Obviously, the item which is rising fastest would be the ideal place to be at any given time.

You can examine these investment categories in a number of ways. Two ways I look at them are: (1) on a beginning of the year to the present basis. To do this all you have to do is run a trendline connecting the first week and the most recent week. Then you simply study the angle of ascent or descent. On this basis, the Dow would be the strongest item on the list.

The second method is to run a trendline connecting the bottoms or reaction lows. Here again, stocks come out ahead, since they show the steepest angle of ascent. On this same basis bonds have not done badly. And gold, if we run a trendline through the February low and the most recent price has not done badly either.

It is well to note that four of the items pictured on this chart are in definite bull trends, the exceptions being the Low-Priced Stock Index, the dollar and the CRB Commodity Futures Index.



The Low-Priced Stock Index has a habit of surging toward the END of major bull markets (reason: the public is the main buyer of the L-P issues). This Index is currently below its 1981 peak (!), and it has been in a declining trend throughout 1986. The pattern of this Index, I believe, is telling us that the bull market in stocks is still far from its final phase. The low-priced stocks have not begun to move yet.

As to the dollar index, this is composed of a number of currencies, but the index is heavily weighted by the yen and the German mark. The declining dollar index is therefore a mirror image of the rising yen and mark. Thus, we know that the yen and the mark have been in strong bull trends in terms of the dollar.

The commodity index looks to me as if it is trying to bottom out. Note that the CRB Index has assumed what could be a huge "head and shoulders" bottom effect. A breakout to the 115 area would complete the bottom and give a decidedly bullish look to the CRB Index. It would also hint of inflation.

LOOKING AHEAD: George Gilder is the author of the widely-read book, "Wealth and Poverty." He recently gave a speech (at the London Conference on Taxes and Growth) which made me think and think again. The reason the Gilder speech had me thinking is that Gilder may have hit on something I have been searching for -- a rationale for the continuation of the current bull market, and perhaps a rationale for a coming period of euphoria in the US.

Here are some of Gilder's thoughts and concepts. He believes that progress in the computer field is about to ACCELERATE dramatically. Progress will accelerate because of THREE CONVERGING developments: (1) the rise of artificial intelligence via the computer. (2) The birth of the computer compiler, which will allow individuals to design programs fitted to their OWN needs. (3) The third breakthrough is parallel programming, in which many computer operations can occur simultaneously. Over the next decade, says Gilder, these three breakthroughs will bring about a massive advance in the cost effectiveness of computer technology.

The landmark phenomena described above will set off a dramatic DECLINE in the value of natural resources. Consider this example: computer chips are made from sand (silicon). A few pounds of sand will produce an amount of fiber-optic cable equal to many tons of copper cable. This simple example implies huge CHANGE in the international power structure.

Nations that dominated because they controlled huge pools of natural resources have also (up to now) experienced great political and economic power. But markets are becoming increasingly global, and the measure of wealth in the future will be technological ability and scientific capabilities. Territorial control by individual nations will mean less and less.

Gilder believes that the balance of power will be switching dramatically against governments and toward individuals and small enterprises. The breakthroughs described above militate in favor of the entrepreneur and the individual rather than the giant company or the state. The NEW POWER is going to be artificial intelligence (which is simply another type of software) and KNOWLEDGE.

What is good for the entrepreneur and the individual is bad for socialism and communism. It follows, then, that the knowledgeable individuals will MOVE to the countries which allow them self-expression and away from socialist states (this is now happening in England, which is experiencing a severe brain-drain).

The freedom of the US plus its new tax system will act as a magnet for the brains of the world. Margaret Thatcher recently stated, "With a top tax rate lower than Britain's bottom rate, the US will attract still more of Britain's most productive scientists and entrepreneurs." The price of government can be expressed in its tax rates. In the new global economy, government will become just another commodity.

The US tax ceiling now presents a massive threat (via the brain drain) to all high-tax governments. The migration of capital and brains to the US is now on in earnest. Says Gilder, "Immigrants are already absolutely critical to the success of American high technology." (Russell comment: note the incredible way that citizens of Asiatic origin are moving to the forefront in US science and technology.) Gilder continues, "Investors are already sending their funds to the US in great quantities. But you haven't seen anything yet. In the next decade, America will be a mecca for all the world's entrepreneurs and investors. Under this pressure, countries everywhere will begin lowering their tax rates to compete. The result will be an overwhelming surge of global growth. We are moving towards a general triumph of capitalism."

So those are the views of George Gilder. I find them highly interesting and certainly plausible. Meanwhile, let's watch the markets. They're aware of Gilder's views too.

NOTES & QUOTES: If you're a NYC hotel owner, it's good news; if you're a visitor to Gotham, it's rotten news. The NYC hotels have now broken the "$200 a room barrier." The NYC Visitors Bureau now lists more than 25 hotels that charge over $200 per night (and with taxes and extras, of course, they'll run more). The hotel owners counter with the news that with the cost of labor contracts going up, they're paying maids $9.50 an hour in the City.

In the meantime, the ritziest of the ritzy, NYC penthouses are priced "through the roof." A survey of 33 penthouses in midtown Manhattan shows an average price of $2.5 million, prices running from a measly $1.25 million for the penthouse at 309 E 49th St. to $6.5 million for the pinnacle of 500 Park Tower on Park Avenue. Latest rumor is that Sylvester Stallone has put down a deposit on a huge $12 million NYC apartment.

Russell's story: When I left NYC in 1961 I gave (transferred) my $235-a-month, two-bedroom apartment (at 125 E 93) to a buddy. The building went coop, and my friend bought the apartment for something like $6,000. Six years later he sold it for $85,000. I met him in New Orleans in 1985, and he said if he had the apartment today he could sell it for $350,000. But I'm not sorry I left Gotham, I'm just sorry I didn't keep the apartment.

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San Diego: In 1960 there were 2 1/2 times as many marriages as divorces in San Diego. Last year in San Diego there were 11,300 marriages and 13,650 divorces. What's happened? Two expert opinions from educators here: One attributes it to the yuppie mentality. "Their philosophy says that anything that holds you back should be gotten rid of." The other says, "People here appear to have a problem with commitment. Life is so freewheeling in California, and there are so many ways of gratification."

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USA: FBI statistics show that in 1985 there were 450,000 violent crimes committed in US schools and colleges. Assaults accounted for the majority of cases, robbery and rape for most of the remainder. Nationally, 29% of school-age students dropped out in 1985, up 26% from 1984. Of kids that don't go to school, 12% stay out because of fear.

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Pablo Picasso, the most influential artist of the 20th century, died at age 91, leaving no will. His estate took six years to settle amid anger, much litigation, and an army of 50, including a large squabbling family, lawyers, appraisers, dealers, art experts. Picasso was the most prolific artist in history, and his works in total are now valued at over $1 billion. Picasso left 1,885 paintings, 1,228 sculptures, 7,089 drawings, 30,000 prints, 150 sketchbooks, 3,222 ceramic works, as well as two chateaux, three other homes, bonds, cash, and gold. Picasso would fill a house with his art, then simply move out (leaving his art) into the next house or chateau. Picasso married twice and also lived for 10 years each with two other women. He married for the second time when he was 80. Picasso predicted that settling his estate would "be worse than anything you can imagine." His statement proved prophetic.

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Why do people live in crowded Washington, DC? Well, for one reason, our seat of government has the lowest unemployment rate in the nation. The biggest paycheck in Washington (seriously) is Moses Malone's (of basketball fame) check for $2,145,000. Second, $1.3 million to Allen Neuharth, CEO of Gannett. Next, Washington Post CEO Katherine Graham at $1.2 million. Top government salary: President Reagan at $200,000. How about this: Average salary for the 286,914 federal employees in Washington -- $32,210. Government, anyone?

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I've always been of the opinion that when this economic boom is over, the US restaurant business (particularly the fast food chains) is going to be decimated. Why? Because the easiest area to cut back on expenses is the "eating out" area. When I was a kid our family used to eat out maybe once every two weeks. Eating out was an extravagant treat. Not so today when one out of every three meals is eaten out.

At any rate, the fast-food statistics are amazing. The biggest chain is McDonalds with 1985 sales of $11 billion and 8,901 restaurants. Second is Burger King with $3.9 billion in sales from 4,225 outlets. Third is Kentucky Fried Chicken with $3.1 billion in sales from 6,396 outlets. Fourth is Wendy's with $2.7 billion in sales from 3,459 outlets. Fifth is Hardee's with $2.4 billion in sales from 2,111 outlets.

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President Reagan in the last five years has vetoed a mere 33 bills. Other presidents have vetoed hundreds of bills. Reagan has been willing to accept all kinds of pork barrel extravagance in order to pass major bills that will keep the nation going. In other words, he has never had the guts to bring on a real confrontation. And that is one of the main reasons why this Administration has run up the disgusting series of over-$200 billion deficits.

Speaking of our president, Lou Rukeyser just put out his tongue-in-cheek list of '86 Xmas gifts. Here are Lou's distressingly accurate comments about Reagan: "The president's foreign affairs follies have been distracting attention from the general collapse of his second term domestically. Even before the revelation that much of the US overseas policy had been turned over to the Keystone Kops, Reagan was going nowhere on the economic ideas that originally brought him to Washington: lower spending, lower (not just allegedly "fairer") taxes, balanced budgets and steeply reduced bureaucracies. The status quo in Washington has triumphed so spectacularly that probably the most unsettling and revolutionary gift I could give the chief executive this

Christmas would be — a bound copy of the forgotten speeches of Ronald Reagan."

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Sex report: Of American girls in the 15 to 19 year age group, a whopping 11% now get pregnant. On a state-by-state study, Nevada's young ladies rate highest with 14.4% of them getting pregnant. Second are the girls from California at 14%. Icy N. Dakota has the lowest pregnancy rate at 7.5%.

* *

You name it, I read it. I mean, I read A LOT. But the best thing I've read on the Iranian mess comes from James Reston's Dec. 4 column in the NY Times (nobody has a clearer or fairer concept of what goes on in Washington than Reston). Here's an excerpt from the Reston column:

> **Accordingly, what started as an adventure within the White House and developed into both a farce and a tragedy, is now a tangle of legal obscurities, with the attorney general hoping to investigate his own government's misconduct, and six or seven congressional committees promising to carry out their separate investigations, no matter how long it takes next year, when the Democrats will be in control of the investigative committees of the Congress.**
>
> **To many leaders of the President's own party, this is a nightmare. They are urging him to make a clean sweep of all the principal officials of the Cabinet and the White House who had anything to do with approving this secret shipment of arms to Iran and money to the *contras*, or whoever got the scratch — nobody yet knows.**
>
> **This means firing Donald Regan, the White House chief of staff, and William Casey, the head of the Central Intelligece Agency, who are suspected of knowing about the deal for arms for Iran even if they did not know about all of North's financial maneuvers to get money to the contra rebels in Nicaragua.**
>
> **The President, however, is in an awkward position to clean house, even though he proclaimed Ollie North "a national hero" and fired him. For he still insists that this whole disaster wasn't a fiasco or even a "mistake" or a "failure", but merely a procedural misjudgment that was carried out without his complete knowledge.**
>
> **Unfortunately, the White House adventures in Iran and Nicaragua are being compared to President Nixon's calculated deceptions at Watergate. This is a bad analogy, for several reasons.**
>
> **Nixon covered up his illegal activities, but Reagan and his attorney general announced the follies of Iran and Nicaragua. The main question for Nixon was what did he know and when did he know it; the embarrassing question for Reagan is what didn't he know and why didn't he know it.**

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Computers and medicine: Up to now, if you wanted to know what your heart and arteries were doing (were they clogged, etc.), you had a treadmill test (which simply provided hints) and then an angiogram (which is much more accurate). An angiogram entailed passing a tube into your leg and along the artery all the way up to your heart. A dye was then released, and the physician could track the blood flow (or lack of flow) via the dye and X-rays. I had an angiogram last July prior to bypass surgery. The angiogram is invasive, and is really a form of surgery. Put it this way -- it was no fun.

Now GE has come up with a form of magnetic resonance imaging (MRI). Weak radio signals are emitted by atoms in the body when those atoms are exposed to a powerful magnet. This produces still images. But GE has produced a computer program which actually suppresses the signals from stationary tissues while highlighting the images of moving cells -- the faster the movement, the brighter the image. Next, the researchers hope to adapt the technique to see the flow of blood inside the heart — they will do this by cancelling out the action of the beating heart. If this works, angiograms will be history.

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Statistics: Violent crime in San Diego is up 37% over last year. ... Height in men equals money: statistics show that for each extra inch in height, a man will earn $600 more per year.

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Salaries: According to Fortune, Michael Milken (Drexel, Burnham) makes between $25 and $55 million per year. ... The Indianapolis Colts are sure to get a crack at first-draft-choice Vinnie Testaverde: The price estimated to get Testaverde is a contract for $10 million!

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Football: Of the many thousands of high school and college football players, few make the NFL draft. Last year the NFL picked a total of 433 players. Of those 433, few are playing on a first team this year. In San Diego, of 17 players drafted in '86, five are still on the team and only three are starting players!

* *

The GM buyout of H. Ross Perot goes down in my book as a new low in corporate public relations. After offering Perot $700 million for his class E stock, Perot did something only a billionaire could do. He stated, "Why should I take this money? It would be morally wrong. I don't need it. But the money could be put to a lot of use within General Motors." Then Perot gave GM 15 days to think over their absurd offer. Of course the meaning of the GM offer couldn't have been clearer to Wall Street (where the class E stock dropped 4 1/2 points the next day). The GM brass was telling Perot that it couldn't take any more of his criticism, and they were blatantly buying him off. My bet: The management of GM that bought off Perot will go before GM returns to prosperity (it is rumored that Ford's profits will pass GM's in 1987).

* *

Sometimes a cartoonist can get over the story better than a full length book. I thought this cartoon was both funny and ominous:

Happy Holidays: I always feel that the Holidays bring with them an awful lot of good feelings and an awful lot of hypocricy. Christmas celebrates the birth of Christ, and I think it's ironic that Christmas in America has, to some extent, degenerated into a sort of "boom time" for the retail stores, and a toy harvest for a lot of kids (not all the kids, by any means, but a lot of them). Actually, Christ, as we know him in the Gospels, had no possessions at all except for a robe and a pair of sandals. After Christ was crucified, the Roman soldiers gambled for his robe as a souvenir.

Forgetting my grouchy mumblings about the retail explosion, I do want to wish all my subscribers (yeah, and readers) the very best for the Holidays. The year 1986 was a very tough year for me, but it ended up fine, and as Shakespeare put it, "All's well that ends well." At any rate, I hope it's a great year for all you characters in 1987.

POINT & FIGURE: In the last Letter I discussed the market (specifically the Dow) as interpreted under Elliott. In this Letter I want to discuss the Dow via point & figure. I show here Chartcraft's P & F chart of the Dow. One advantage of P & F is that it CONCENTRATES movement (without regard to time). Here we see all of 1986's Dow action on one small chart. This particular P & F chart entails a good deal of concentration since it is a 10 x 30 chart. This means that each box on the chart equals 10 Dow points, and only rallies or declines of 30 points or more are depicted (X's on the chart indicate rallies, O's indicate declines).

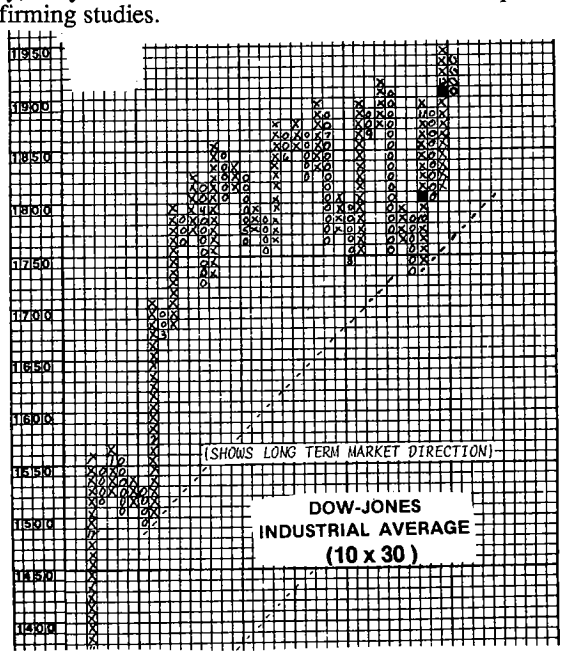
Upside reversals are signaled under P & F whenever a row of X's pushes over the last row of X's. Declines are signaled when a row of O's drops below the last row of O's. Each rally or decline is considered to remain in force until cancelled by a reversal signal.

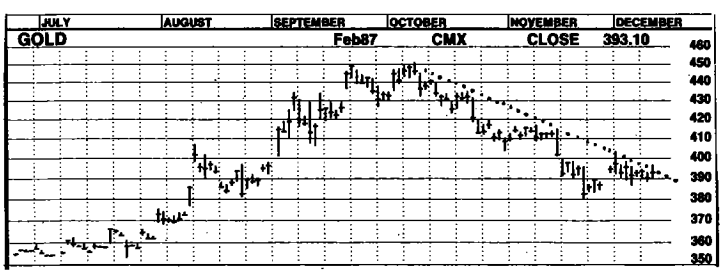
The chart shows that the Dow has been in a trading range since April with reversal signal after reversal signal being given. The last signal occurred at 1810 (lower black box). This was a bull signal in that the row of X's bettered the preceding row of X's. A second (confirming) bull signal was given (second higher black box) when the preceding row of X's at 1900 was bettered. The third reconfirming signal was given at 1930 when the previous highest row of X's at 1920 was bettered.

An interesting facet of P & F charting is that the charts provide targets or counts. There are two types of counts, the horizontal and the vertical count. The horizontal is a bit complicated, and so I will discuss the vertical here. The vertical is based on the momentum of the breakout move. The last reversal on the chart was a bullish reversal. This bullish move began at1750 and ended at 1900. This is a rise of 16 boxes or 160 points. Because we are dealing with a 30 point (3 box) reversal chart, we multiply the 160 points by 3, which gives us 480 points. We add the 480 to the low point of the last decline (i.e., 1740) and that gives us a count or an upside projection for the Dow of 2220.

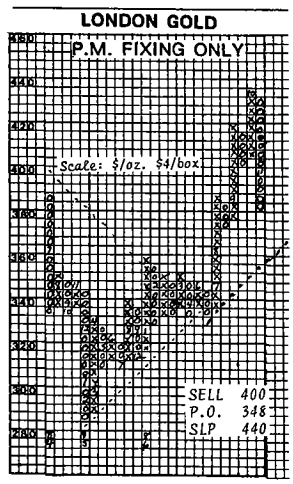
What might happen to cancel out that upside count? The count would be canceled by a Dow decline to one box below the last row of O's, and that means that on this chart the Dow would turn bearish on a move to 1800 or below. A further bearish confirmation would occur if the Dow declined below its rising trendline -- or if it declined to 1760 or lower.

How accurate is the P & F count? In bull markets, upside counts tend to be met fairly often; in other words, they tend to be pretty good. In bear markets, upside counts are far less accurate (as is to be expected). In general, I use P & F charts as a check on my own Dow Theory work and as a general aid in simplifying the picture. P & F charts take absolutely NO note of time, they are based solely on price movement. Thus, they give a simplified, concentrated, and very useful picture of the price structure. But like any other market study, they should not be used alone but as complimentary or confirming studies.





GOLD: Let's examine the point & figure chart of gold (chart courtesy of Chartcraft, Larchmont, NY). From a price of 436 recorded in October, gold has corrected back to the 384 level, a loss of 11%. Good support for gold should (and is) coming in at the August level of roughly 376-380. The rising trendline extending from the June low comes in at around 356-360, and it is here that I would expect the strongest support for gold.



The bar chart of the February gold contract (charted Tuesdays and Thursdays) shows the metal hitting a recent low of 380 and then rallying to the 400 area. Note that gold is now pushing against the declining trendline, a bearish trendline that has held gold in a declining phase for the past three months. If February gold can get above 405, I would say that such a move would constitute a bullish reversal.

In the meantime, if you have been accumulating gold coins as I have suggested, I wouldn't be disturbed by the recent action. Personally, I LIKE the gold action. First, I like it because despite the lack of inflation during 1986, gold has held to a long–term bullish pattern, a bullish pattern which BEGAN in February 1985 from a low London fix of 284.25. And second, I like the gold action because I consider gold under 400 to be in an advantageous ACCUMULATION area.

As far as I'm concerned, I wouldn't mind if gold held below 400 for the next year or so. I'm not buying gold to make a killing, and I'm not buying gold to trade it out in a year or so. I'm buying gold because it represents the only asset I have (besides my home) that has no debt against it (and, of course, stocks, bonds, most real estate, and the dollar itself -- all these assets have debt against them).

When the next bear market finally arrives, I expect it to be a debt-crushing killer. That's when real money (gold) will come into its own.

LATE NOTES: In Letter 952 and again in Letter 953 I noted that the market as measured by the A-D ratio was in "a corrective phase." It's still in that phase. Despite power or holding ability in the Dow Averages (and in the S&P Averages), the majority of stocks is putting on a desultory performance.

So as I see it, January and February are fated to be test months for the stock market. I say this because the Dow and most of the high-capitalization averages have had to "go it alone" for the better part of 1986 (or ever since late–April when the daily advance-decline ratio recorded its peak).

What we're seeing is actually a very unusual picture. It's unusual because although the A-D ratio peaked back on April 21, the ratio has never dropped as much as 4 points below its April 21 high. In other words, most of the action in the A-D has been sideways since the high (you can see this on the page 2 chart). This lag or declining phase in the A-D ratio is not going to last forever. Ultimately, the lagging breadth is either going to set off a broad market correction (taking the Dow with it) or the A-D is going to bottom out, and join the Dow on the upside.

Many observers believe that the Dow strength has been mainly a reflection of takeover deals or of arbitrage. If that is so, much of this strength should unwind during the first months of 1987. Time will tell, but any correction should be seen as occurring within the context of a bull market. The nearby support point for the Dow (based on my 5 x 15 point & figure chart) is 1885. The 144-day (exponential) moving average of the Dow stands at 1826.

NEXT MAILING: Dec. 31